AUSTRALIAN CO-OPERATIVES NATIONAL CONVENTION SPECIAL FEATURES OF CO-OPERATIVE FINANCING

By Mr. R.M. Graham

Finance Manager Westralian Farmers Co-operative

Introduction

The distinctive features of co-operative principles create opportunities and problems in co-operative financing.

Those principles and consequences arising from them which have considerable impact on financing include:-

1. The emphasis on benefits going to members in proportion to trading with the company,

2. The limitation on dividends to be paid on members' share capital,

3. Democratic control of the co-operative by members usually involving rules on voting rights and transferability of shares,

4. Retentions to include funds for education and future development of the co-operative.

These principles which impact on the financial operations of co-operatives have been variously translated in Australian Statutes and by individual co-operatives. Companies Acts in some States apply certain requirements on "co-operatives" not greatly different in substance from the main co-operative principle. Australian income tax laws add several special interpretations including

1. "not less than 90% of business to be done with members"
2. Limitations on individual shareholding

and

3. Prohibiting listing of co-operative shares on stock exchange or on their sale in any public manner.

In many cases where co-operatives have not be specifically bound by some statutory requirement their own memorandum and articles of association have defined special versions of co-operative requirements which apply to their operations. However in discussing the subject of co-operative financing it is desirable to recognise that there are many features that are common to those of any other economic enterprise.

Some of the common features are

(a) Well planned and worthwhile objectives

(b) Adequate prospects for successful operation giving rewards to shareholders or members.

(c) Sound financial policies and management

Co-operatives as well as other companies and economic enterprises share and in many cases, compete for, the same financing sources,

e.g. Loans from banks and other credit institutions.

Mortgage moneys.

Hire purchase.

Leasing and other "off balance" sheet sources.

Trade credit

Bills of Exchange

Debenture and Deposit Funds

Ordinary Share Capital

Preference Share Capital

Internally Generated Financing

None of these should be excluded from appropriate consideration simply because the enterprise is a co-operative.

Special Features

In approaching the special features of financing co-operatives it is necessary to stress that Co-operatives are economic units. They can only be justified by the level of benefits they bring to members. "Service" co-operatives have no future unless the service gives some additional economic benefit to members. This is fundamental to the continued operations of co-operatives.

Raising Members' Ordinary Capital

The raising of this has several features in common with that of any other type of company,

(a) Holding it must be attractive enought to obtain subscription from shareholders and potential shareholders,

(b) The shareholding must bring continued benefits.

In co-operatives however, the major differences are,

(a) That the shareholding is normally limited to persons who wish to trade with the co-op.

(b) Rewards are limited - generally precluding capital gain.

(c) Transferability is normally restricted and at times difficult.

(d) Higher shareholding does not increase voting power or control of the co-operative.

These restraints are frequently and perhaps correctly raised as detriments to the adequate capitalisation of co-operatives. Problems which are seen include

> The lack of shares value appreciation,
> could or should this be remedied by
> including in co-operative principles,
> the right to make bonus share issues
> in certain conditions

Under existing laws it would appear possible to make share issues from reserves in proportion to trading done over several years past (but not in proportion to shareholding).

If in fact shareholding percentages bear some or close relationship to trading percentages then a bonus issue from reserves or even from asset revaluations reserves would be equitable and valuable to members.

This strategy would not assist a situation where levels of capital provided were significantly different from the level of business done. In these cases the making of bonus issues to the providers of capital would appear equitable in circumstances, such as in high inflation periods when a limited dividend did not adequately reimburse the shareholder for use of his capital.

This returns us to the earlier question as to whether co-operative principles and practice should be amended to allow for bonus issues in proportion to capital.

Another approach to the problem which was brought forward in Canada - and which may be more relevant in a "no par" share value system is interesting. The proposal was that shares in the co-operative should from year to year be increased in "par value" by adding some proportion of the increased book value arising from the plough back to reserves,

i.e., if the additions to reserves were equal to 20 cents per share then it could be decided to increase the "par value" of say $1.0 shares to a new value of $1.10.

This would be the basis on which retiring shareholders desiring to dispose of shares would be paid out and the price at which new shareholders were admitted. The proposal no doubt has its problems to be overcome if it was to be implemented but there is a degree of equity in an approach which gives some share value growth factor to current shareholders and requires new shareholders to contribute towards the demonstrably enhanced value of shares through retentions of profits.

I believe that there are some new dimensions to be established in the members' capital area of co-operatives. However any changes must not upset the basic principles of co-operation

through too much emphasis on return on capital. The higher this is allowed to become the lower the benefits which can be distributed to those who do business with the co-operative.

However a balanced solution of these issues should remove some of the detriments frequently associated with the attraction of capital and holding of shares in co-operatives.

In view of the potential benefits the amount of capital provided by the rural sector to co-operatives is a small portion of total rural assets.

Preference Share Capital

There is a place for the use of preference capital as a supplement to members' ordinary capital. An issue of preference capital with redemption rights can at times enhance the equity situation of the Co-operative in such a way that it does not conflict with or impinge on the ownership and control by ordinary shareholders.

Revolving Fund Members' Capital

The technique of obtaining members' capital by a deduction from proceeds or from profits is well known and well established in co-operative circles. It is important in such systems to endeavour to keep the revolving cycle to a reasonable period.

Care is needed in establishing the basis of the cycle if the product on which the levy is to be made is one which has a history of substantial production or price fluctuations. The capacity to repay at the end of the cycle period may be affected by coinciding with a low production or price year.

In some situations co-operatives have retained small fractions of realisation on produce sold on behalf of members as a non returnable reserve fund. This method has resulted in the accumulation of substantial funds for the use of the co-operative.

Production Guarantees

A system by which producers give undertakings or guarantees that they will provide a certain quantity of production of a particular commodity over a period of years is in use in Europe. These production guarantees are used as a financing medium by processing and marketing co-operatives. The system is said to be acceptable to credit institutions and is a partial substitute for lack of adequate cash capital subscription by producers. The co-operative processing and marketing venture is able to borrow on a particular recourse (if necessary) on its members - but in the case of those members each is limited to the guaranteed production only.

The system could have merit and relevance to processing and marketing co-operatives and should be further investigated.

Reserve Bank of Australia - Rural Credits

Many co-operatives have established their eligibility for advances from the Reserve Bank to

make advances on specified commodities to producer members and to meet processing and marketing costs. These essentially require compliance with certain rules and principles established by the Bank - rules which are compatible with co-operative principles.

Given basic security and sound management experience, the level of advances available generally expands in relation to the level of production delivered and the market prospects and value. The rate of interest charged is favourable and advances are normally re-negotiated each year or each season.

The use of this form of finance places processing and marketing co-operatives in a favourable competitive situation for a large part of their working funds. In most cases the cost of these funds is only marginally more costly to eligible co-operatives than to statutory marketing authorities operating under government guarantees.

Pooling of Members' Sales Proceeds

The role of co-operatives in this field is again well known. It is still however, an area in which initiatives should be taken. Co-operatives should aim to provide producers with an alternative to statutory or compulsory marketing authorities. Many producers have apparently become disenchanted with the normal merchant marketing systems for their produce and have pressed for statutory authorities. Preferring presumably the fixed or equalised price basis of remuneration for produce.

The availability of special finance for pooling systems should be utilised by co-operatives to establish such marketing systems wherever feasible.

Banks For Co-operatives

In the United States of America the establishment of Banks for Co-operatives arose from far sighted moves in the 1920's and early 1930's. Certain Government moneys which had been made available to the farm sector on a long term loan basis for reconstruction purposes was initially controlled by a United States Government agency which made loans and progressively re-lent to other rural producers the amounts which were repaid to it. As this operation developed into a continuing commercial rural loan system it was decided by Congress that the operations may be more appropriately run on co-operative lines. To bring this about the United States Government in effect gave up its claim to the repayments of the loans and these became the capital of the Banks for Co-operatives on which a major nationwide banking structure has been developed. This is no doubt an oversimplifaction of the innovation.

However the importance of expanded and specialised credit sources for co-operatives in Australia raises the question as to whether some parallel may not exist with "rural reconstruction" loans. The question as to whether there is a case for submission to Governments could be studied.

Internally Generated Funds

These hold a significant place in the financing of any commercial enterprise. Because co-operatives have the freedom (subject to member willingness) to retain funds by appropriation on which the co-operative has not paid income tax as well as retentions on which tax has to be

paid the source is of substantial benefit. The setting aside of adequate funds for depreciation and for other internal provisions and reserves is commercially prudent and adds strength to the co-operative.

Use Of Joint Ventures

Where the capital required is beyond existing or foreseeable resources then some aspects of an operation may be appropriately entered into under joint venure or joint company arrangements.

Income Tax On Co-operatives

This subject is one of great importance in developing co-operative financing strategies. It is the subject of a special paper to be presented to the conference and therefore is not covered in these notes.

Whilst strategies should be directed towards achieving optimum taxation benefits it is desirable that these do not result in unbalanced profits distribution patterns.

Profits Determination And Distribution

Co-operatives have to balance a number of factors in determining the basis of profits distribution.

e.g., Amount of Profits Retention for Future Needs

Whether to retain as a general reserve with income tax implications or to retain funds through allocation to shareholders or members.

Amount of Dividend to be Paid on Capital

Whether to pay at maximum rates allowed under the law or by the co-operative's rules. If income tax treatment is different between dividends and trading bonuses the decision is made more difficult.

Amount of Trading Bonus to Members

In multi-purpose co-operatives the distribution requires equitable balancing between different products or services. Should all products qualify or is the distribution to be made only on those products or services deemed to be profitable, is a question to be decided.

The form of the distribution is one in which a further set of judgements is needed. These must balance the needs of the co-operative with those of its members. Issues of shares, debentures or some form of revolving certificate all have a place as well as bonus payments in cash.

The payment of bonuses in shares, debentures or other "paper" forms place a special responsibility on the co-operative to ensure that the worth of this paper is maintained. A.

Financial Implications Of Co-operative Takeovers And Mergers

There is a long history of co-operatives taking over other co-operatives and other companies, and of non-co-operative companies taking over co-operatives. Where the benefits arising from such takeover activities are adequate and equitable then the situation is sensible and supportable. Q.

The position where a takeover offer is made without the approval of the Board of the Co-operative brings into calculations the financial or economic performance achieved on behalf of members - and also the possible future performance of the co-operative. On the face of it the value of the shares of a successful co-operative must always be in excess of their par value. Hence any offer or current "market" price for such a co-operative will be higher than par. The "defence" of the co-operative's position must rest mainly on having a shareholding membership that is satisfied that the present and future benefits of continuing co-operative service outweigh a single capital payment for their shares. A. Q.

Conclusion

A number of special features exist in co-operative financing, some may be deemed detriments - most are favourable. The existence of these features do not exempt co-operatives from complying with all the best elements of financial planning and management. A.

Co-operatives exist in an overall commercial environment which is neither hostile to or necessarily favourable to co-operatives. Comm by

The commercial world will however make its judgements when dealing with co-operatives on its own well tried rules.

e.g., Level of Equity

Earnings Record Comm by

Management Ability

Security

Past Record of Meeting Commitments etc.,

In the final analysis the success of a co-operative will depend on its ability to develop plans and programmes that will work.

QUESTIONS TO - R.M. GRAHAM

Q. R.R. Larcombe - Grazcos

What protection is offered to rural co-operatives to avoid takeover where the financial structure appears attractive to some major non-co-operative organisation?

A. In New South Wales the Minister has power to prevent this course of action.. He will be guided by the decision of members three-quarters of whom must agree by postal vote and if such percentage does agree then it does not necessarily follow that the Minister will authorise the move though he will certainly be guided by this indication of members views.

Q. T. Kelly - Railway Staff Credit Union

A committee already exists undertaking studies into the establishment of a Co-operative Bank. If a rural Co-operative Bank were to be proposed surely it would be possible for a combination of research to be made to ensure one Co-operative Bank is established to satisfy the needs of all areas of Co-operation rather than having two Co-operative Banks in Australia.

A. There is certainly much value in the proposal that there should only be one Bank and it is more likely to be accepted and successful if all interested parties could meet and talk over research carried out up to date and future requirements for such a project.

Q. M. Clayton - Westralian Farmers

Would the Canadian practice of increasing par value of Co-operative shares be possible of adoption in Australia?

A. At first sight it would appear not immediately possible and the authority of the Court would probably be required to increase the share values.

Comment by

D. Horton - Registry Co-operative New South Wales

The New South Wales Co-operative organisations are looking currently at imposing a premium on newer members being admitted to membership of Co-operatives to compensate for inflationary trends and to reward the founders and earlier subscribers to the Co-operative capital.

Comment by

A.J. O'Neil - Grazcos

Bonus shares are being currently used as a method of repayment of inflated share capital to older members.